

Res Judicata
Setoff
Chapter 13 confirmed plan

In re Jan Vanderspek and Barbara Gleasman 696-63082-fra13

11/23/97 FRA Unpublished

The Debtors had not yet filed their 1995 federal income tax return when they filed for bankruptcy on 6/25/96. The IRS objected to confirmation of the Chapter 13 Plan because of the missing tax return; the court confirmed the Plan on 9/25/96 subject to the continuing objection of the IRS. The Plan provided for full payment of secured and priority unsecured tax debt. On 7/22/97, the IRS withdrew its objection upon the filing of the tax return and almost immediately moved for relief from stay to set off the refund from the 1995 return against priority unsecured taxes. Debtors objected, arguing that the confirmed plan provided that the tax refund be paid over to the Trustee. In the event that setoff were allowed, Debtors asked that the IRS be required to allocate the refund against secured tax debt. The IRS argued that its setoff rights were not affected by confirmation of the Plan, citing In re DeLaurentiis Entertainment Group, Inc..

The court did not address the issue of the priority of setoff rights over provisions of a confirmed plan, holding instead that confirmation of the Plan in this case could not have any res judicata effect with respect to the tax refund in question. The tax return had not been filed at the time of confirmation and the refund had not been scheduled. Because neither the court nor interested parties, including the IRS, were on notice of the refund at the time of confirmation, the IRS could not be bound to the terms of the Plan with regard to the refund and the IRS's setoff rights could not be affected. Because the Debtors failed to explain how the feasibility of their plan depended on the allocation of the IRS's setoff, the IRS's general right to allocate as it sees fit was also not affected.

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8 UNITED STATES BANKRUPTCY COURT
9 DISTRICT OF OREGON
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11 IN RE)
12) Case No. 696-63082-fra13
13 JAN VANDERSPEK and)
BARBARA GLEASMAN,)
14) MEMORANDUM OPINION
Debtors.)

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16 The Internal Revenue Service (IRS) has filed a motion for
17 relief from the automatic stay to allow it to set off a tax
18 refund which is owing to the Debtors for a pre-petition tax year
19 against the Debtors' pre-petition tax liability, specifically
20 against a priority tax penalty. The Debtors object on the
21 grounds that their confirmed Chapter 13 Plan of Reorganization
22 directs that tax refunds be paid over to the Trustee and that the
23 IRS will be paid in full for priority and secured tax debts. In
24 the alternative the Debtors request that, should the court rule
25 that the IRS is entitled to a setoff, the IRS be ordered to set
26 off the refund against secured tax liability.

1 Because I find that the doctrine of res judicata is not
2 applicable with respect to the tax refund, I will allow the
3 Government's motion.
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5 BACKGROUND

6 The Debtors filed a bankruptcy petition on June 25, 1996 and
7 a Chapter 13 Plan which requires that the Debtors turn over to
8 the Trustee all tax refunds received; it also states that all
9 property described in 11 U.S.C. § 1306(a)(1) and (2) shall remain
10 property of the estate.¹ It provides for payment in full over
11 the term of the Plan the IRS's secured and priority tax claims of
12 \$16,556.07 and \$20,302.96, respectively. Neither the schedules
13 of assets filed with the petition nor any subsequent amendments
14 disclose any right to a tax refund.

15 The IRS objected to confirmation of the Plan when it found
16 that it had no record of the Debtors having filed a 1995 federal
17 income tax return. The Plan was confirmed on September 25, 1996
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19 ¹ 11 U.S.C. § 1306(a) reads as follows:

20 (a) Property of the estate includes, in addition to the
21 property specified in section 541 of this title—

22 (1) all property of the kind specified in such section
23 that the debtor acquires after the commencement of the case but
24 before the case is closed, dismissed, or converted to a case
25 under chapter 7, 11, or 12 of this title whichever occurs first;
26 and

(2) earnings from services performed by the debtor
after the commencement of the case but before the case is closed,
dismissed, or converted to a case under chapter 7, 11, or 12 of
this title, whichever occurs first.

1 subject to further objection by the IRS. On July 22, 1997, the
2 IRS withdrew its objection to confirmation, presumably upon the
3 Debtors' filing of their 1995 federal income tax return. On
4 September 26, 1997, the IRS filed the present motion for relief,
5 asking the court to allow it to set off the overpayment of \$8,265
6 from the recently filed 1995 tax return against a pre-petition
7 priority civil tax penalty.

8 Debtors argue that the provisions of their confirmed Plan
9 require that the tax refund be paid over to the Trustee and,
10 further, that the IRS be paid over the term of the Plan.
11 Confirmation of the plan is *res judicata*, and the IRS cannot now
12 seek different treatment of the tax refund. In re Ground Systems
13 ____ BR ____ (BAP 9th Cir. 1997), Trullis v. Barton, 107 F.3d
14 685 (9th Cir. 1995). If a setoff is allowed, the Debtors urge
15 the court to direct that the refund set off against secured,
16 rather than priority, debt, pursuant to In re Moore, 200 B.R. 687
17 (Bankr. D. Or. 1996).

18 Relying on Carolco Television, Inc. v. National Broadcasting
19 Co. (In re DeLaurentiis Entertainment Group, Inc.), 963 F.2d 1269
20 (9th Cir. 1992), cert denied, 506 U.S. 918 (1992), the government
21 asserts that the terms of a confirmed plan do not affect the
22 rights of a creditor to setoff under Bankruptcy Code §553.
23 Moreover, the Internal Revenue Code, at 26 U.S.C. §6402, confers
24 on the IRS the right to designate the account or tax against
25 which any setoff is to be applied. The government acknowledges,
26 however, Moore's holding that the right of allocation is subject

1 to a showing that another application is required to preserve the
2 feasibility of a plan of reorganization.

3 DISCUSSION

4 1. Effect of Confirmation

5 It is well established that "Once a bankruptcy plan is
6 confirmed, it is binding on all parties and all questions that
7 could have been raised pertaining to the plan are entitled to res
8 judicata effect." Trullis v. Barton, et al. 107 F.3d 685, 691
9 (9th Cir. 1995). Res judicata bars a party from bringing a claim
10 if a court of competent jurisdiction has rendered final judgment
11 on the merits in a previous action involving the same parties and
12 claims. *Id.*; In re Int'l Nutronics, Inc., 28 F.3d 965, 969 (9th
13 Cir.), cert. denied, 513 U.S. 1016 (1994).

14 The question here is whether confirmation of the plan in
15 this case constituted an adjudication of the parties' rights
16 regarding the tax refund. Clearly it did not. As noted, the
17 Debtors did not disclose the existence of the refund in their
18 schedules.² Since Debtors had not filed a return for the tax
19 year in question, the Government cannot be said to have had
20 notice of the potential refund. The Government cannot be bound
21 by the plan's disposition of the refund when the refund's
22 existence was not disclosed. More to the point, the plan cannot

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24 ²It appears that the Debtors filed their return for the tax
25 year after confirmation. The Government's motion was made after
26 the return was filed, and the right to a refund became known to
it. However, there is nothing in the record to suggest that
Debtors were aware of the potential refund when they filed their
petition and schedules.

1 conclusively dispose of an asset if neither the parties nor the
2 court is aware of its existence.

3 Debtors rely on the following language in their plan:

4 1. Property described in 11 USC §1306(a)(1)
5 & (2) shall remain property of the estate
6 after confirmation and is submitted to the
7 supervision and control of the Court. The
8 debtor shall pay to the trustee (a) a
9 periodic payment of **\$1,250 every month;**
(b) all proceeds from avoided transfers; (c)
all tax refunds received by the debtor; (d) a
lump sum payment of ----- on -----; and (e)
for 36 months; \$2,000 per month and
continuing until all 507 claims are paid.

10 The quoted language is from a form chapter 13 plan
11 promulgated by the Court. The form plan is used almost
12 universally in chapter 13 cases in Oregon. The bold portions are
13 the "variables" filled in by the debtors. The reference to
14 "property described in 11 U.S.C. §1306(a)(1) & (2)" would include
15 the tax refund, since the right to it existed at the time the
16 case was filed. However, since the Debtors presumably did not
17 know about the refund at the time, the language was either
18 intended to apply to other assets, or left in simply as
19 boilerplate. Superfluous language in form plans should not be
20 given preclusive effect when it appears that the language does
21 not reflect an actual adjudication, and when it is not sufficient
22 to put a creditor on notice that its interests are to be
23 affected. See Cen-Pen Corporation v. Hanson, 58 F.3d 89 (4th
24 cir. 1995).

25 Since the plan does not adjudicate the disposition of the
26 Debtors' tax refund, it remains subject to the Government's

1 setoff rights under 26 U.S.C. §6402 and 11 U.S.C. §553.

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5 2. Application of proceeds

6 Ordinarily the Government may allocate funds subject to
7 setoff however its interests may dictate. 26 U.S.C. §6402 In re
8 Moore, 200 B.R. 687 (Bankr. D. Or. 1996) recognizes this right,
9 but holds further that the court has the discretion to direct the
10 manner of the allocation if failure to do so would render a
11 confirmed plan unfeasible. Moore at 690.

12 The Debtors' plan provides for payment in full of both the
13 secured and unsecured priority claims of the Government.³ The
14 IRS proposes to allocate the \$8,265 refund to the unsecured
15 priority portion; Debtors seek an order allocating the refund (if
16 setoff is allowed) to the secured debt. Debtors do not explain
17 how the government's proposed allocation diminishes their ability
18 to reorganize. Since the proposed allocation would not affect
19 the Debtor's ability to reorganize under Chapter 13, the
20 government's right to allocate is not subject to limitation under
21 Moore.

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23 CONCLUSION

24 1. Provisions of a confirmed plan purporting to control the
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26 ³It could not have been confirmed otherwise, since secured
and priority claims must be paid in full. 11 U.S.C. §1325.

1 use or allocation of an asset are not binding if the asset was
2 not scheduled, and affected parties had no knowledge of the
3 assets' existence.

4 2. Where a plan's feasibility is not diminished by a
5 proposed allocation, the Government may allocate funds acquired
6 under its setoff rights.

7 This Memorandum Opinion constitutes the court's findings of
8 fact and conclusions of law, which will not be separately stated.
9 Counsel for the United States shall submit an order consistent
10 herewith.

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13 FRANK R. ALLEY, III
14 Bankruptcy Judge
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